control and relevant legal arguments supporting A's position to the appropriate Internal Revenue Service personnel. Accordingly, the position of the Internal Revenue Service was substantially justified at the time the costs were incurred.

Example 2. In the purchase of an ongoing business, taxpayer B obtains from the previous owner of the business a covenant not to compete for a period of five years. On audit of B's individual income tax return for the year in which the business is acquired, the Internal Revenue Service challenges the basis assigned to the covenant not to compete and a deduction taken as a business expense for a seminar attended by B. Both parties agree that the covenant not to compete is amortizable over a period of five years. However, the Internal Revenue Service asserts that the proper basis of the covenant is $2X while the taxpayer asserts the basis is $4X. Thus, under the Internal Revenue Service's position, B is entitled to a deduction of two-fifths $X in the year under audit and for each of the subsequent four years. B's position, however, would result in a deduction of four-fifths $X for the year under audit and each of the subsequent four years. The deduction for the seminar attended by B was reported on the return in question in the amount of $X. The Internal Revenue Service's position is that the deduction for the seminar should be disallowed entirely. In the notice of deficiency, the Internal Revenue Service determines adjustments of two-fifths $X (the difference between the Internal Revenue Service's position of two-fifths $X and the reported four-fifths $X) regarding the basis of the covenant not to compete, and $X resulting from the disallowance of the seminar expense. Thus, of the two adjustments determined for the year under audit, that attributable to the disallowance of the seminar is larger than that attributable to the covenant not to compete. However, due to the impact on the next succeeding four years, the covenant not to compete adjustment is objectively the most significant issue to both B and the Internal Revenue Service.

Example 3. The Collection Branch of a Service Center of the Internal Revenue Service determines in the matching process of various Forms 1099 and W–2 that taxpayer C has not filed an individual income tax return. The Internal Revenue Service sends notices to C requesting that C file an income tax return. C does not file a return, so the Service Center's Collection Branch prepares a substitute for return pursuant to section 6020(b). The calculation is sent to C requesting that C either sign the return pursuant to section 6020(a) or file a tax return prepared by C. C does not respond to the Internal Revenue Service's request and the Service Center's Collection Branch issues a notice of deficiency based on information in its possession. C does not file a petition with the Tax Court and does not pay the asserted deficiency. The Internal Revenue Service then assesses the tax shown on the notice of deficiency and issues a notice and demand for tax pursuant to section 6303. After receiving notice and demand, C contacts the Collection Branch and convinces Collection to stay the collection process because C does not owe any taxes. The Collection Branch recommends that the Examination Division examine the tax liability and make an adjustment to income. The Examination Division then redetermines the tax and abates the assessment due to information and arguments presented by C at that time. The costs C incurred before the Collection Branch are incurred in connection with an action taken by the Internal Revenue Service to collect a tax. Therefore, these costs are incurred with respect to a collection action and not an administrative proceeding. Accordingly, they are not recoverable as reasonable administrative costs. Costs incurred before the Examination Division are reasonable administrative costs; however, C may not recover any reasonable administrative costs with respect to the proceeding before the Examination Division because, as of the date the costs were incurred, C had not previously presented all relevant information under C's control and all relevant legal arguments supporting C's position to the Collection Branch or Examination Division personnel (the appropriate Internal Revenue Service personnel under § 301.7430–5(c)), and thus, the position of the Internal Revenue Service was substantially justified based upon the information it had.

[T.D. 8542, 59 FR 29364, June 7, 1994, as amended by T.D. 8725, 62 FR 39119, July 22, 1997]

§ 301.7430–6 Effective dates.

Sections 301.7430–2 through 301.7430–6, other than §§ 301.7430–2(b)(2), (c)(3)(i)(B), (c)(3)(ii)(C), and (c)(5); §§ 301.7430–4(b)(3)(i), (b)(3)(ii), (b)(3)(iii)(B), (b)(3)(iii)(C), (b)(3)(iii)(D), and (c)(2)(ii); and §§ 301.7430–5(a) and (c)(3), apply to claims for reasonable administrative costs filed with the Internal Revenue Service after December 23, 1992, with respect to costs incurred in administrative proceedings commenced after November 10, 1988. Section 301.7430–2(c)(5) is applicable March 23, 1993. Sections 301.7430–2(b)(2), (c)(3)(i)(B), and (c)(3)(ii)(C); 301.7430–4(b)(3)(i), (b)(3)(ii), (b)(3)(iii)(B), (b)(3)(iii)(C), (b)(3)(iii)(D), and (c)(2)(ii); and 301.7430–5(a) and (c)(3) are applicable for administrative proceedings commenced after July 30, 1996. Sections 301.7430–1(e), 301.7430–2(c)(2), 7430–3(a)(4) and (b) are applicable with respect to actions taken by the Internal Revenue Service after July 22, 1998.

[T.D. 8725, 62 FR 39119, July 22, 1997, as amended by T.D. 9050, 68 FR 14320, Mar. 25, 2003]

§ 301.7430–7 Qualified offers.

(a) *In general.* Section 7430(c)(4)(E) (the qualified offer rule) provides that a party to a court proceeding satisfying the timely filing and net worth requirements of section 7430(c)(4)(A)(ii) shall be treated as the prevailing party if the liability of the taxpayer pursuant to the judgment in the proceeding (determined without regard to interest) is equal to or less than the liability of the taxpayer which would have been so determined if the United States had accepted the last qualified offer of the party as defined in section 7430(g). For purposes of this section, the term *judgment* means the cumulative determinations of the court concerning the adjustments at issue and litigated to a determination in the court proceeding. In making the comparison between the liability under the qualified offer and the liability under the judgment, the taxpayer's liability under the judgment is further modified by the provisions of paragraph (b)(3) of this section. The provisions of the qualified offer rule do not apply if the taxpayer's liability under the judgment, as modified by the provisions of paragraph (b)(3) of this section, is determined exclusively pursuant to a settlement, or to any proceeding in which the amount of tax liability is not in issue, including any declaratory judgment proceeding, any proceeding to enforce or quash any summons issued pursuant to the Internal Revenue Code (Code), and any action to restrain disclosure under section 6110(f). If the qualified offer rule applies to the court proceeding, the determination of whether the liability under the qualified offer would have equaled or exceeded the liability pursuant to the judgment is made by reference to the last qualified offer made with respect to the tax liability at issue in the administrative or court proceeding. An award of reasonable administrative and litigation costs under the qualified offer rule only includes those costs incurred on or after the date of the last qualified offer and is limited to those costs attributable to the adjustments at issue at the time the last qualified offer was made that were included in the court's judgment other than by reason of settlement. The qualified offer rule is inapplicable to reasonable administrative or litigation costs otherwise awarded to a taxpayer who is a prevailing party under any other provision of section 7430(c)(4). This section sets forth the requirements to be satisfied for a taxpayer to be treated as a prevailing party by reason of the taxpayer making a qualified offer, as well as the circumstances leading to the application of the exceptions, special rules, and coordination provisions of the qualified offer rule. Furthermore, this section sets forth the elements necessary for an offer to be treated as a qualified offer under section 7430(g).

(b) *Requirements for treatment as a prevailing party based upon having made a qualified offer*—(1) *In general.* In order to be treated as a prevailing party by reason of having made a qualified offer, the liability of the taxpayer for the type or types of tax and the taxable year or years at issue in the proceeding (as calculated pursuant to paragraph (b)(2) of this section), based on the last qualified offer (as defined in paragraph (c) of this section) made by the taxpayer in the court or administrative proceeding, must equal or exceed the liability of the taxpayer pursuant to the judgment by the court for the same type or types of tax and the same taxable year or years (as calculated pursuant to paragraph (b)(3) of this section). Furthermore, the taxpayer must meet the timely filing and net worth requirements of section 7430(c)(4)(A)(ii). If all of the adjustments subject to the last qualified offer are settled prior to the entry of the judgment by the court, the taxpayer is not a prevailing party by reason of having made a qualified offer. The taxpayer may, however, still qualify as a prevailing party if the requirements of section 7430(c)(4)(A) are met. If one or more adjustments covered by a qualified offer (see paragraph (c)(3)) are settled following a ruling by the court that substantially resolves those adjustments, then those adjustments will not be treated as having